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Supreme Court, U.S.
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No. 96-252

In The
Supreme Court of the United States
October Term, 1996

CORRECTED COPY

DCX, INC.,
Petitioner,

vs.

WILLIAM J. PERRY,
SECRETARY OF DEFENSE,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

BRIEF *AMICI CURIAE* OF THE COLORADO ASSOCIATION OF COMMERCE AND INDUSTRY, and DEFENDERS OF PROPERTY RIGHTS ** IN SUPPORT OF PETITIONER

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CONTRACT ELECTRONICS
ASSOCIATION
OPHIR CORPORATION

QUESTIONS PRESENTED FOR REVIEW

1. Whether the Due Process Clause of the Fifth Amendment requires a government agency to provide notice and a pre-deprivation hearing before terminating a procurement contract for default?

2. Whether the Due Process Clause of the Fifth Amendment prohibits government agencies from arbitrarily and capriciously terminating contracts for a delay caused by the government?

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Pursuant to Rule 37.2 of the Rules of this Court, *amici curiae* submit this brief in support of Petitioner.

IDENTITIES AND INTERESTS OF *AMICI CURIAE*

Defenders of Property Rights is the nation's only legal defense foundation devoted exclusively to protecting private property rights. Defenders was founded as a non-profit, public interest firm in 1991. Its mission is to protect vigorously those rights considered essential by the Framers of the Constitution, and to promote a better understanding of the relationship between private property rights and individual rights and liberty. Defenders of Property Rights engages in litigation across the county on behalf of its members to prevent government incursion into protections guaranteed by the Bill of Rights. Defenders devotes a significant portion of its resources to litigation and has participated in *Lucas v. South Carolina Coastal Council, Dolan v. City of Tigard* and *Babbitt v. Sweet Home Chapter Communities for a Great Oregon* when they were before this Court.

The Colorado Association of Commerce and Industry is a statewide, broad based, member organization representing the Colorado business community.

STATEMENT OF THE CASE

Petitioner, DCX, Inc., is an established manufacturer of electrical components based in Franktown, Colorado. Petitioner has designed and built many complex electrical

systems for the federal government, including components for the Saturn V Apollo moon rocket, the Navy's standard missile system, and the "smart bomb" ordinance system for the F-16.

Petitioner was awarded three contracts by Respondent, Defense General Supply Center, for manufacture of electrical components which would be used in the TEMPER medical tents: two for electrical power supply and distribution systems and one for fluorescent light sets, the contract in dispute in this case. A dispute arose between the parties over the feasibility of some of Respondent's specifications for the power supply systems. During the negotiations between the parties to prevent a termination of the two power supply contracts for default, Petitioner proceeded with performance of the third contract for the light sets.

Under that contract, the light set design was to be tested and a First Article Test Report ("FATR") was to be submitted to ensure that the light sets met government standards. Petitioner subcontracted with Ball Aerospace Corporation ("Ball") to conduct the tests because it had the only facility in the region with the required capability.[1] Due to the tight delivery schedule, Petitioner proceeded with production before FATR approval, even though the costs of making changes to any parts which are required to obtain FATR approval are normally borne by it as the contractor. Based on its long history in contracting with the government

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[1] Not only is Ball the only facility in the region with the capacity to do the required testing, it is one of the premier testing facilities in the county. Moreover, subcontracting with one of the few other laboratories with the same capability would have been commercially impracticable for Petitioner.

to design and build similar electrical devices, Petitioner believed that such a relatively simple apparatus would undoubtedly meet the government's criteria.

Ball, however, was delayed in testing the light assemblies due to an urgent, classified order by a separate government agency which had higher priority under the Defense Priorities and Allocations System, 15 C.F.R. §350 *et seq.* In light of the fact that the government itself caused the delay, Respondent granted Petitioner a twelve-day extension to allow Ball to complete the test and issue the report.

On the new deadline date, July 12, 1988, Ball was entering the final stages of the test procedure. Petitioner had sent a memo explaining that while the FATR would again be delayed due to yet another government project taking priority over Petitioner's lower-priority project, but that such delay would not prevent Respondent from meeting the first delivery date. Unfortunately, however, this time Petitioner and Respondent were embroiled in an acrimonious dispute regarding the other two contracts. Apparently in a fit of pique, rather than respond to explanation that the delay was again caused by the government, on July 13, 1996, Respondent simply terminated all three contracts -- the two disputed contracts plus the lighting contract not in any way involved in the dispute.[2]

Under the Government's Federal Acquisition Regulations ("FAR"), the terminating contract officer ("TCO")

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[2] Ironically, at the time the government terminated the lighting contract, the other contractor responsible for manufacturing the tents to house the lights was also behind schedule.

is required to evaluate a number of factors prior to terminating any contract, including, notably, whether the contract default was excusable given the totality of the circumstances. 48 C.F.R. §49.402-3(f). The FAR also specifically require the TCO *prior to* terminating a contract to consider the urgency for the contract fulfillment, the reasons proffered by the defaulting party, and the consequences to both parties as a result of contract default. *Id.*

In the instant case, there is no question that the TCO failed to follow the FAR. Indeed, the TCO testified at trial that not only did he not undertake the evaluation required by the FAR, but that he did not believe the factors relevant to the decision to terminate Petitioner's contract:

> JUDGE HARPER: In other words, the Government, whether it's you or whoever it is for the Government comes in and says stop what you're doing and hold that up, do this. If you had understood that was the reason that DCX was late in delivering this first article report, would it have changed your feelings about termination?
>
> WITNESS: I'd have to say no.

Tr. at 73, Pet. App. at 40.

Because Petitioner had been previously granted one extension on the contract, the TCO believed that he was not bound by FAR with respect to the instant contract termination. Tr. at 46-48, Pet. App. at 37-39. Accordingly, the TCO wrote the termination memorandum and had it approved within five hours without conducting any of the required inquiries. Tr. at 79-83, Pet. App. at 41-45.

SUMMARY OF ARGUMENT

Just three years ago this Court held that "the right to prior notice and a hearing is central to the Constitution's command of due process." *United States v. James Daniel Good Real Property*, 510 U.S. 43 (1993). As this Court explained:

> The purpose of this requirement [of due process] is not only to ensure abstract fair play to the individual. Its purpose, more particularly, is to protect his use and possession of property from arbitrary encroachment -- to minimize substantively unfair or mistake deprivations of property.

Id. at 50, *quoting Fuentes v. Shevin*, 407 U.S. 67, 80-81 (1972).

Certainly Petitioner in this case was not treated fairly. It received absolutely no notice whatsoever before the Respondent decided unilaterally to terminate the contract for default. The constitutional question presented for review, thus, is whether Respondent has infringed Petitioner's right to due process by failing to afford notice and a pre-deprivation hearing (*i.e.*, an opportunity to explain to the TCO the basis for the delay) prior to terminating the contract. The extent to which government agencies are bound by the requirements of the Due Process Clause in their dealings with contractors when terminating procurement contracts is presently "uncharted territory" for this Court.

The applicable principle for this issue would appear to be found in this Court's landmark decision in *Goldberg v.*

Kelly, 397 U.S. 254 (1970). *Goldberg* established that, in certain instances people deprived of property interests by government action have the right to notice and a hearing prior to the deprivation of the interests.

Subsequent to *Goldberg*, this Court in *Mathews v. Eldridge*, 424 U.S. 319 (1976), established a balancing test for determining the circumstances in which a pre-deprivation hearing would be required. Under that test three factors are to be considered: (1) the nature of the private interest affected by the failure to provide procedural safeguards; (2) the risk of an erroneous deprivation of such interest through the procedures used, and the probable value of any safeguards; and (3) the burdens imposed on the government of providing additional safeguards. *Id.* at 335.

This Court has applied the *Mathews* test in a number of instances including civil seizure of property pursuant to a drug offense, *United States v. James Daniel Good Real Property*, 510 U.S. 43 (1993), and termination of teachers from a public school system, *Cleveland Bd. of Educ. v. Loudermill*, 470 U.S. 532 (1985).

Despite the clear principles articulated by the *Goldberg/Mathews* Courts, the United States Court of Appeals for the Federal Circuit continues to render decisions at odds with this Court's holdings and other lower courts' holdings. For example, in addition to the decision below, the Federal Circuit also has refused to require a pre-deprivation hearing even in situations where a government contractor was facing suspension of bidding privileges -- a veritable death

sentence for a company relying on government contracts. *See, e.g., NKF Engineering v. United States,* 805 F.2d 372 (Fed. Cir. 1986); *ATL, Inc. v. United States,* 736 F.2d 677 (Fed. Cir. 1984).

The refusal of the Federal Circuit to require the government to afford due process in the context of government contracting is a problem of special importance because it is the court of review for all contract claims for money damages against the federal government under the Tucker Act. 28 U.S.C. § 1346. Thus, review by this Court is necessary to provide guidance to this important forum - the Federal Circuit (and the U.S. Court of Federal Claims) -- regarding whether a pre-deprivation hearing is required in suits involving government procurement contracting.

Equally important is the second issue raised in this Petition regarding the arbitrary and capricious nature of the contract termination that took place. As the name of the clause implies, due process is specifically designed to probe whether the process by which rights are infringed is fair. *Daniels v. Williams*, 474 U.S. 327, 331 (1985)(purpose of the Due Process Clause is to prevent government from abusing its power or employing it for purposes of oppression). Where the process afforded to terminate contracts is unfair, or when government decision makers succumb to private biases or interests, then clearly the Due Process Clause is implicated. The Due Process Clause, quite simply, forbids all deprivations of property by governmental action that is arbitrary,

unreasonable or violative of fundamental principles of fairness. U.S. CONST. Amend. V.

Thus, the issue in a due process case is not whether the government had the *power* to terminate the contract, but whether the deprivation of property has been accomplished in a manner protective of fundamental individual rights. In the present case, the government not only failed to follow its own rules for terminating the contract, but did so for arbitrary and abusive purposes, unrelated to any legitimate government interest.

Nevertheless, the court below upheld Respondent's failure to afford due process protections to Petitioner. Without guidance from this Court with respect to these important constitutional issues, the door is thus wide open for government to deprive private contractors of their constitutional right to due process in an arbitrary and unfair manner. Accordingly, *amici curiae* strongly urge this Court to grant Petitioner the writ of certiorari.

REASONS FOR GRANTING THE PETITION

I. THIS CASE RAISES AN ISSUE OF CRITICAL IMPORTANCE TO GOVERNMENT CONTRACTORS -- WHETHER THE DUE PROCESS CLAUSE REQUIRES A GOVERNMENT AGENCY TO PROVIDE NOTICE AND A PRE-DEPRIVATION HEARING PRIOR TO TERMINATING A CONTRACT FOR DEFAULT.

The Due Process Clause of the Fifth Amendment provides that "[n]o person shall be . . . deprived of life, liberty, or property, without due process of law . . ." U.S. CONST. Amend. V.

The essential guarantee of the Due Process Clause is that of fairness. Government actions that deprive an individual of life, liberty, or property must be fundamentally fair. In practical terms, what the Due Process Clause means is that at a minimum when facts or issues are disputed, then the person whose interests are at stake must be granted a fair procedure to resolve the dispute. *United States v. James Daniel Good Real Property,* 510 U.S. 43 (1993).

In the present case, the procedure utilized to terminate the contract -- depriving Petitioner of its property -- was decidedly not fair. First, there was no notice whatsoever of Respondent's intent to terminate the contract. This meant that

any steps Petitioner could have taken to have avoided the default were foreclosed. The purchasing contracting officer ("PCO") simply conducted a cursory inquiry and filled out the necessary paperwork to effect termination by default of the contract? The notice of intent to terminate the contract was the termination itself.[3]

The injury to Petitioner resulting from this lack of prior notice is palpable. Petitioner did not have an opportunity to comment on the decision of the PCO nor to cure the alleged defects upon which the PCO purported to base his termination decision. Petitioner was presented with a costly (in terms of money and potential damage to reputation) termination by default as a *fait accompli.*[4]

In *Mathews v. Eldridge,* 424 U.S. 319 (1976), this Court set out a balancing test for determining the circumstances in which a pre-deprivation hearing would be required. Under that test three factors are to be considered:

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[3] The TCO testified at trial that because Petitioner had been already given one extension, he believed that he was not bound to inquire into the basis for the second delay. Tr. 45-47, 48, 61, 64. The logic in this reasoning appears to be that if the government treats a contractor fairly once, then the next time the government is entitled to be arbitrary. Needless to say, there is no basis in the Due Process Clause for such a principle.

[4] A termination by default is said to be the fault of the contractor, and results in the contractor losing all rights under the contract once it is terminated, no matter how much the contractor has already performed in reliance upon the contract. A termination by convenience, on the other hand, is taken as a termination at the will of the government, and gives the contractor certain rights to reimbursement. *See, e.g., State of Florida, Dept. of Insurance v. United States,* 81 F. 3d 1093 (Fed. Cir. 1996)(termination by default could not be converted into termination by convenience where no injury was shown); *Ellett Construction Co., Inc. v. United States,* 93 F.3d 1537, 1547 (Fed. Cir. 1996)(contract canceled for convenience allowed contractor to be reimbursed for costs and profits).

> First, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and, finally, the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail.

Id. at 335.

Application of these factors strongly suggests that Petitioner should have been entitled to a pre-deprivation hearing (such as an opportunity for Petitioner to explain to the TCO) prior to the termination of its contract:

A. SUBSTANTIAL PRIVATE INTERESTS WILL BE AFFECTED BY THE OFFICIAL ACTION.

Parties contracting with the government have a legitimate interest in the procedure utilized by government agencies for terminating contracts. This is because contracts often establish "legitimate claims of entitlement" recognized as property. *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972). Indeed, courts routinely enforce contracts, and award damages against those who go back on their word. Moreover, the Constitution itself protects contracts. Article I, section 10, clause 1 provides that "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts." Likewise, the

government may be required to pay "just compensation" under the Takings Clause of the Fifth Amendment for actions that deprive an owner of his contract. *Lynch v. United States*, 292 U.S. 571, 579 (1954).[5]

Moreover, the economic interests of the contracting party with the federal government often constitutes a significant portion of the contracting company's entire business. The financial impact on the Petitioner in this case as a result of the challenged contract cancellation has been significant. Not only has it resulted in no payment being received for performance already rendered, but additionally, and perhaps more importantly, Petitioner relies heavily on government contracts for its business. Termination by default may also have a permanent chilling effect on the future ability of Petitioner to contract with the federal government.

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[5] This Court has explicitly recognized that intangible property rights are deserving of Fifth Amendment protection. In *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1001 (1984), this Court noted that: "we are mindful of the basic axiom that '[p]roperty interests . . . are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law.'" *See also Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 161 (1961), *quoting Board of Regents v. Roth*, 408 U.S. 564, 577 (1972).

B. THERE IS A HIGH RISK OF ERRONEOUS DEPRIVATION OF THE PRIVATE INTERESTS WITHOUT PROCEDURAL DUE PROCESS OR EQUIVALENT PROCEDURES, AND THE VALUE OF PROVIDING ADDITIONAL SAFEGUARDS IS SIGNIFICANT.

Under the holding of the court below, the risk of erroneous termination facing any government contractor is high. For if the contracting officer only performs a cursory inquiry, which is less than the requirements under the FAR, there is no way for the contractor to try to prevent a default termination from being ordered by the contracting officer based on inadequate findings. Allowing contractors to have notice and a pre-deprivation hearing would make it more difficult for the contracting officer to in fact perform inadequate inquiries, such as occurred in the instant case, and it would tend to have prevented a default termination of Petitioner's contract without valid reason.

Moreover, as pointed out in the Petition, because government contracts represent a substantial portion of the federal budget, a process that enables government to procure goods and services efficiently which requires certainty in the process, should be encouraged.

C. PROVIDING ADDITIONAL SAFEGUARDS WOULD ALSO BENEFIT THE GOVERNMENT.

As discussed above, the government's interest in contracting with suppliers such as Petitioner is the efficient ordering and procurement of needed goods and services. This interest would be *enhanced* if notice and a pre-deprivation hearing were provided as required by applicable regulations. The arbitrary and capricious acts of the government in this case not only denied without due process the rights of Petitioner, but also were the least efficient method of obtaining the goods originally contracted for by the government. A pre-deprivation hearing would allow the contractor to at least partially perform the contract, thereby reducing the delay and costs of finding new suppliers.

Indeed, the government has already provided an efficient and effective means for providing due process, by requiring the equivalent of notice and a prehearing deprivation hearing in the FAR. Thus, it would appear that the government recognizes its interest are served by using every means possible to encourage performance of contracts.

Finally, since an Armed Services Board of Contract Appeals ("ASBCA") hearing is always available after the entry of default termination, failure to provide notice and a pre-deprivation hearing (or to comply with the FAR) requires potentially a greater expenditure of government resources than would be expended by simply requiring the PCO to seek an

explanation from the contracting party prior to terminating the contract, a pre deprivation hearing has the added benefit of potentially saving government recourses.

II. THE DUE PROCESS CLAUSE OF THE FIFTH AMENDMENT SHOULD ALSO PROHIBIT GOVERNMENT AGENCIES FROM ARBITRARILY AND CAPRICIOUSLY TERMINATING CONTRACTS FOR DEFAULT.

A contract with the federal government is not like a contract between private parties, because unlike private parties who can breach a contract at will, the government owes a duty of fairness to its citizens even when it contracts with them. Specifically, the Due Process Clause of the Fifth Amendment imposes a duty which prohibits the government from acting arbitrarily and capriciously whenever it deprives a person of property, in this case, contract rights. U.S. CONST. Amend. V.

Similarly, as discussed above, to guard against the arbitrary or unwarranted termination of contracts, the government is required to evaluate a number of factors contained in the Federal Acquisition Regulations:

> 1. The terms of the contract and applicable laws and regulations.
>
> 2. The specific failure of the contractor and the excuses for the failure.
>
> 3. The availability of the supplies or services from other sources.

> 4. The urgency of the need for the supplies or services and the period of time required to obtain them from other sources, as compared with the time delivery could be obtained from the delinquent contractor.
>
> 5. The degree of essentiality of the contractor in the Government acquisition program and the effect of a termination for default upon the contractor's capability as a supplier under other contracts.
>
> 6. The effect of a termination for default on the ability of the contractor to liquidate guaranteed loans, progress payments, or advance payments.
>
> 7. Any other pertinent facts and circumstances.

48 C.F.R. §49.402-3(f).

Not only is the government bound by the applicable regulations, but compliance with these factors assures the contracting parties that the contract termination process is fair. Moreover, compliance with the FAR helps insure that the termination is not based on arbitrary, capricious or abusive purposes. In the instant case, analysis of these factors was *not* undertaken and the contract was *arbitrarily* canceled for what appear to be for spiteful purposes.

The court below erroneously held that FAR and the applicable regulations in 48 C.F.R. Sec. 49.402-3(f) cannot be viewed as binding objective standards guaranteeing due process to private contractors in the termination of contracts with the government. Further, the court below erroneously held that the FAR conferred *no rights* on the private contracting party:

> The second regulatory provision on which Petitioner relies, 48 C.F.R. § 49.402-3(f), requires a contracting officer to consider various factors before exercising his discretion to terminate a contract when the contractor is in default. . . . [T]he factors in section 49.402-3(f) that contracting officers are directed to consider before terminating contracts are not prerequisites to a valid termination.

Pet. App. at 8a.

In sharp contrast with the holding of the court below, however, this Court has repeatedly held that government regulations have the "force and effect" of law and do in fact confer enforcement rights on its citizens. *Chrysler Corp. v. Brown*, 441 U.S. 281, 295 (1979). As this Court explained in *Udall v. Tallman*, 380 U.S. 1 (1965), the public relies and makes economic decisions based on government rules and laws and even practices:

> [G]overnment is a practical affair, intended for practical men. Both officers, lawmakers, and citizens naturally adjust themselves to any long continued action of the Executive Department, on the presumption that unauthorized acts would not have been allowed to be so often repeated as to crystallize in a regular practice. . . .

Id. at 17, *quoting United States v. Midwest Oil Co.*, 236 U.S. 459, 472-3 (1914).

The decision below flies in the face of this reasoning by upholding or "crystallizing" an arbitrary termination process at odds with the government's own long-standing, published regulations (FAR). Indeed, the clear purpose

behind the FAR is to ensure that the government *avoid* capriciously terminating a contract without undertaking a thoughtful review of various factors set forth in the applicable regulations. In light of this plainly prescribed process contained in the FAR, which essentially embody the requirements of due process, it is strange, indeed, for the lower court to suggest that the FAR is merely advisory, and that the government agency can at its discretion decide whether or not to act fairly. Surely if constitutional due process means anything, it must mean that when government processes are fair, then they must be followed in every instance, and not just when the government is so inclined.

CONCLUSION

Accordingly, for all the foregoing reasons, *amici curiae* strongly urge this Court to grant the requested Petition for Writ of Certiorari and provide guidance to the lower courts regarding the role, if any, of the Due Process Clause in the context of government procurement contracts.

Respectfully submitted,

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